

**Remarks by Linda G. Davenport
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at

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Conference on New Markets Tax Credit Program**

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Good morning! Thank you for that kind introduction.

I am glad that I have this opportunity to talk to you about the important activities of the CDFI Fund, and specifically about the New Markets Tax Credit Program.

The CDFI Fund is an integral part of Treasury's strategy for promoting a prosperous U.S. economy and helping to create jobs for those that need them. The mission of the CDFI Fund is to expand the capacity of financial institutions to provide capital, credit and financial services in underserved markets. The Fund accomplishes this mission by providing monetary awards, training and tax credit allocations to financial institutions and other entities focused on serving low-income communities and underserved populations.

The New Markets Tax Credit Program was established by Congress in December 2000. The program permits taxpayers to receive a credit against their Federal income taxes for making Qualified Equity Investments in organizations known as Community Development Entities. The CDEs are responsible for making qualified

investments with those dollars into low-income communities. Through this mechanism, the NMTC Program has the potential to bring a total of \$15 billion in private sector money to work in some of our nation's most distressed areas over the life of the program.

We are excited by the high level of interest demonstrated in this program over the last several years and by the potential this program has to stimulate private sector investment in the economic development of low-income communities and its potential to make a real difference in the lives of the people in these communities.

Before I go into detail about the New Markets Tax Credit Program, I want to bring you a message from Art Garcia, the Fund's Director. As we near the end of our fiscal year in September, Art has led the Fund to conduct "Business as Usual" during this year, and if he were here today, he would tell you what that has meant for us at the Fund over the last few months.

"Business as Usual" has meant ensuring that nearly \$40 million available for the Fund's monetary award programs this fiscal year be obligated. I am happy to report that the Fund completed the obligation of those funds at the end of July. Award notices for the Bank Enterprise Award Program and the Technical Assistance Component of the CDFI Program were announced this week. We awarded nearly \$10 million in BEA awards to 53 organizations and over \$2 million in 41 Technical Assistance awards. The Financial Assistance Component awards and the awards made under our Native American CDFI Assistance program will be announced before the end of September.

"Business as Usual" also relates to the New Markets Tax Credit Program. Secretary Snow announced the recipients of the \$2 billion in tax credit allocations authority the Fund had available in the third round this May. Cumulatively, 170 allocation awards totaling \$8 billion have been made to 154 organizations. The Fund announced the

fourth round of the New Markets Tax Credit program – with \$3.5 billion of allocation authority - on July 15, with a CDE certification application due date of August 22 and an NMTC application deadline of September 21. We hope those of you who plan to apply were able to tap into our videoconference last week, and if you did not, you may obtain a copy of the presentation by contacting the Fund.

NMTC proceeds may be used to finance a wide variety of activities, including:

- Loans to or equity investments in businesses. Approximately \$486 million (24%) of NMTC proceeds will likely be used to finance and support loans to or investments in businesses in low-income communities. Allocatees have proposed strategies ranging from microenterprise lending to multi-million dollar venture capital investments.
- Loans to or equity investments in real estate projects. Approximately \$1.21 billion (61%) of NMTC proceeds will likely be used to finance and support real estate projects in low-income communities. Most real estate projects, with the general exception of projects consisting mainly of residential rental housing, are permissible under program regulations. Allocatees have indicated that they intend to make investments in commercial, retail, industrial, mixed-use and homeownership projects, as well as in community facilities such as daycare centers, healthcare centers, and charter schools.
- Capitalization of other CDEs. Approximately \$292 million (15%) of NMTC proceeds will likely be used to provide capitalization for other CDEs. Allocatees may make direct loans to or investments in other CDEs to finance NMTC-eligible activities, or may purchase NMTC-eligible loans originated by other CDEs. This will help ensure continued availability of capital in low-income communities.

While all allocatees are required to invest in low-income communities, most of the 2005 applicants also committed to invest NMTC proceeds in areas characterized by more severe economic distress, i.e. areas that have significantly higher poverty rates and lower median family incomes than those minimally required under the NMTC Program. By this, I mean areas that have unemployment rates at least 1.5 times the national average; and/or areas that have been designated for economic development through other governmental programs such as Brownfields, Empowerment Zones and Renewal Communities.

Of the 41 allocatees, 37 indicated that at least 75% of their activities will be provided in these areas of more severe economic distress, and 20 indicated that 100% of their activities will be provided in such areas.

All 41 of the allocatees indicated that at least 75% of their loans and investments will have flexible or non-traditional features, 39 said at least 95% of their investments would have such features and 36 of the 41 allocatees indicated that 100% of their loans and investments will have flexible or non-traditional features. Such features include, among other things: equity and equity-equivalent terms and conditions; subordinated debt; below market interest rates; and reduced origination fees.

All 41 of the allocatees indicated that they would invest more than the minimally required 85% of QEI dollars into qualified low-income community investments, and 35 of the 41 allocatees indicated that at least 95% of their QEI dollars would be invested into qualified low-income community investments. In real dollars, this means at least \$200 million above and beyond what is minimally required under the NMTC program will be invested in low-income communities.

In all these cases the Fund will require these allocatees, through their allocation agreements, to meet the benchmarks identified in their applications. This is an important point to stress, as we do hear from time to time a concern that allocatees may describe a terrific business strategy, but go on to invest in transactions which simply meet the minimum statutory requirements. We expect to send the form of the allocation agreement that the 2005 allocatees will use to them very shortly.

Through yearly refinements to the application and to the allocation agreement, the Fund has sought to “raise the bar,” so to speak, to require allocatees to use the business strategy they described in their applications when making investments. Not only does this make the each round more competitive, but it also maximizes the use of the subsidy provided by the New Markets Tax Credits to harder-to-do transactions or harder-to-reach markets and usually on terms and conditions not generally available in the market.

In the 2006 application round, for example, new questions were added to the application to better determine whether applicants:

- Will commit to providing products on terms that are at least 25% better than comparable market offerings;
- Will commit to serving communities characterized by extremely high poverty, high unemployment, extremely low median family incomes, or by multiple indices of distress;
- Can demonstrate a track record of tracking and achieving impacts in low-income communities;
- Are charging fees that are reasonable and will ensure the benefits of the NMTC will be passed along to borrowers and other end-users.

I believe we are seeing a willingness of applicants to meet the Fund's raised expectations, knowing that they will have to abide by the commitments made in the application when they make investments.

And, through the Fund's Community Investment Impact System - fondly known as CIIS -- the Fund and the IRS will track the actual investments made with NMTC Funds. CIIS will enable us to ensure compliance with the allocation agreements – yes – but as importantly, CIIS will help us analyze many specific details on each transaction in which the New Markets funds are invested. For those of you who are prior allocatees and who drew down QEIs in 2004, you know what I am talking about because your organization just reported its data to CIIS this June 30.

Of course, any of you who have entered into QEIs since last December are also welcome to begin reporting your data as early as September 1st and you can see our website for details! The more information the Fund has, the more we expect to demonstrate that the New Markets Tax Credits are creating the incentive its supporters had hoped for to attract new capital to riskier transactions in markets and communities they would not otherwise have considered for investment. I want to thank those of you who reported and let you know that almost every CDE who we believe was required to submit transaction level reports through CIIS did so, and we are now in the process of cleaning up the data so we can analyze it and draw conclusions about the program's effectiveness from it.

While it is important to hold each allocatee to the compelling features of their applications, we believe that the Allocation Agreements have been crafted to reflect a balance of holding allocatees to the types of activities described in their applications, while giving them the flexibility to respond to changing market conditions. We believe that this flexibility must be utilized carefully by each allocatee. At the end of the day, we hope both the Fund and those

interested in the program will see that the business or real estate investments made by CDEs were those that demonstrably needed the extra financial boost that the New Markets Tax Credit can provide.

The Fund is planning to use the CIIS data in assessing prior performance of applicants in the current round. Thus, when prior allocatees apply by September 22, a portion of the review process will consider how the prior NMTC allocations to that applicant have been used to benefit the communities in which the investments were made, as well as whether the prior allocatees were able to meet other milestones they may have included in their applications. In addition, the Fund plans to begin its site visits later this summer or early fall to prior allocatees that have reported transaction level data through CIIS. Certainly one aspect of the review will be the correlation of the types of investments actually made with the business and community impact sections of the application.

Looking back over the past three years, I must tell you that we at the Fund continue to be impressed by the response this program has had from the many organizations that work in community development. First, it should be noted that over the 3 completed rounds, we have had a total of 824 applicants requesting \$79.2 billion. Almost \$80 billion dollars that groups firmly believed they could put to work in their communities were they successful in obtaining an allocation! That is remarkable in community development.

And while the requested amount in itself is impressive for a newly launched program, it is even more impressive to see that the rubber is starting to hit the road in earnest. As of August 8, 2005, 88 of the 129 first and second round allocatees have received QEIs from investors. The amount of QEIs received to date by these allocatees totals \$2.37billion.

This represents over one-third of the \$6 billion in allocation authority which allocatees in the first two rounds are now free to issue. In addition, while allocatees are by statute allowed up to five years to raise investor dollars, each of the allocatees in all 3 rounds have or will commit to make a substantial portion of their investments within 3 years.

While I cannot yet give you a description of where the investments have been made, we have some interesting data that has been reported by the allocatees when they register their QEIs in the Allocation Tracking System as well as very preliminary data from CIIS.

For example, I can tell you that of the 66 first round allocatees 50 have issued at least one QEI, leaving only 16 allocatees from that round who have yet to issue a QEI in some amount. The first round allocatees have until September of 2006, generally speaking, to issue 60% of their allocations. 28 of those 66 have already issued 60% of their allocations in our ATS system, obviously well ahead of their requirements; including 14 CDEs that have issued 100% of their QEIs.

In the second round, 38 of the 63 allocatees have issued QEIs, and among them 15 have issued at least 60% of their allocations. Generally speaking, second round allocatees have until September of 2007 to issue 60% of their allocations. We have already received several inquiries about what will happen if allocatees do not meet their commitments to issue QEIs. The Fund has not yet developed policy on this issue. However, given the competitiveness of the program, there seems little justification for the Fund to extend the timeframes to issue the QEIs. If the Fund does de-allocate the tax credit authority from any particular allocatee, the statute gives the Fund until 2014 to award any unused allocation authority.

We have some interesting data on the investor sources of QEIs. Data reported in the Allocation Tracking System indicates that most of the QEI investors are unaffiliated with the applicant. Of the 863 QEI investors identified, 706 (82%) are unrelated to the investee CDE. These unaffiliated investors have invested close to \$1.34 billion into CDE allocatees. In a somewhat related question, allocatees report that 474 of the 863 (55%) of the investors are new to the allocatee, while 389 investors are reported as having worked previously with the allocatee. Lastly, of the 863 investors, 148 (17%) were “pass-through” entities using the leverage structure for a transaction.

Finally, preliminary analysis of the CIIS data shows that by the end of their respective FY 2004s, 50 CDEs had originated 249 loans and investments totaling \$1.3 billion. (Please keep in mind that this is preliminary data that is subject to change once we complete our in-depth review of the data.)

These data are interesting and we want to analyze them further. Which makes this a good time to mention that the Fund will be contracting for an independent evaluation of the New Markets Tax Credit program this fall. Analysis of the data I have mentioned today is among many other issues we expect to understand further through this evaluation. It is our hope that over time it will be possible to measure in some fashion the longer term impacts of NMTC investments on particular communities, including the trade offs being made to achieve an acceptable sharing of the risks and rewards between the investors, the CDEs and the communities and businesses in which the investments are made.

We at the Fund look forward to working with you again in the upcoming round and we especially look forward to working together with you to improve the communities you work so hard in every day.

Thank you.